



## The *Cuban* Case and Confidential Disclosures by Public Companies

The recent U.S. district court opinion in *SEC v. Cuban*,<sup>1</sup> although unlikely to significantly alter corporate practices, is a useful reminder of best practices for corporations and their advisors and shareholders when giving and receiving confidential information. On July 17, 2009, the court dismissed insider trading charges brought by the Securities and Exchange Commission (the “SEC”) against Mark Cuban on the grounds that Mr. Cuban’s verbal agreement to keep certain information confidential did not necessarily imply a duty to refrain from trading on the information. The court’s decision is not final, as it remains subject to amended pleadings and appeal. As a result, it is premature to conclude, based on the *Cuban* case, that trading on material nonpublic information received from a corporate insider is lawful in cases where the recipient agrees only to keep the information confidential. Nonetheless, the *Cuban* case demonstrates that if a company expects the recipient of confidential information not to trade in its securities, it is best to say so explicitly in a written confidentiality agreement.

### The Case of *SEC v. Cuban*

Insider trading cases feature some of corporate law’s most colorful fact situations and the *Cuban* case is no exception. Mark Cuban, the well-known Internet billionaire and owner of the NBA’s Dallas Mavericks, owned shares of common stock of Mamma.com Inc. The CEO of Mamma.com called Mr. Cuban to advise him that the company was planning a private investment in public equity (“PIPE”) offering and to invite him to participate. The SEC alleged that, at the outset of the conversation, the CEO asked Mr. Cuban to keep the information he was about to receive confidential and that Mr. Cuban agreed to do so.<sup>2</sup> Upon hearing of the company’s intention to conduct an offering, Mr. Cuban reacted angrily, stating that he did not like PIPE offerings because they dilute the holdings of existing shareholders. At the end of the call, Mr. Cuban said: “Well, now I’m screwed. I can’t sell.”<sup>3</sup> After a follow-up email sent by the CEO, Mr. Cuban contacted the investment bank conducting the PIPE offering and allegedly received additional confidential details about the offering.<sup>4</sup> Immediately after ending that call, Mr. Cuban directed his broker to sell all of his shares of Mamma.com,<sup>5</sup> which prompted the SEC to bring insider trading charges against Mr. Cuban under Rule 10b-5 under the Securities Exchange Act of 1934.

The district court’s opinion discussed the development of the law of insider trading, noting that insider trading liability under Rule 10b-5 may be based upon one of two theories. Under the

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<sup>1</sup> *Sec. & Exch. Comm’n v. Cuban*, 2009 WL 2096166 (N.D. Tex.).

<sup>2</sup> Complaint, *Sec. & Exch. Comm’n v. Cuban*, No. 3:08-CV-2050-D, ¶ 14 (N.D. Tex. Nov. 17, 2008).

<sup>3</sup> *Id.*

<sup>4</sup> *Id.* at ¶ 17.

<sup>5</sup> *Id.* at ¶ 25.

“classical” theory, a corporate insider is liable for trading on confidential information based on the insider’s breach of his or her duty to the shareholders with whom the insider transacts. Under the “misappropriation” theory, a corporate outsider who has received material nonpublic information may be liable for trading on the basis of such information due to the breach of a duty that the recipient owes to the source of the information, which duty can arise by agreement.

In response to the SEC’s contention that Mr. Cuban’s sale of Mamma.com shares violated Rule 10b-5 under the misappropriation theory, the court noted that while Mr. Cuban agreed to keep the information confidential, he did not agree to refrain from trading in Mamma.com stock and his stock sales did not breach his duty to hold the information confidential. As a result, the court concluded that the SEC failed to properly allege a violation of Rule 10b-5 and dismissed the case against Mr. Cuban. However, the court granted the SEC an opportunity to amend its complaint to allege that Mr. Cuban “undertook a duty, expressly or *implicitly*, not to trade or otherwise use material nonpublic information about the PIPE offering” (emphasis added).<sup>6</sup>

## Implications for Providers of Confidential Information

Companies often use written or oral confidentiality agreements when they provide confidential information to others. For example, such agreements are used in M&A transactions during due diligence to ensure that confidential information revealed through the due diligence process is not used to harm the seller’s competitive position. Confidentiality agreements also are used in private placements of securities for similar reasons.

The terms of the recipient’s obligation vary from agreement to agreement. The most basic form of agreement requires the recipient simply to keep the information “confidential” and usually does not include a comprehensive definition of the term. Mr. Cuban’s agreement fell into this category. More elaborate forms of confidentiality agreements supplement the basic agreement to keep the information “confidential” with: (1) an agreement not to use the information for any purpose other than evaluating the transaction for which the agreement is entered; (2) an agreement not to use the information to violate the federal securities laws; or (3) an agreement not to use the information for the purpose of trading in the company’s securities, or not to trade in the company’s securities until the information becomes public or until the agreement expires, which typically occurs one to two years after execution. Presumably, the district court in *Cuban* would

have found for the SEC and imposed insider trading liability on Mr. Cuban if he had agreed to formulation (3), probably if he had agreed to formulation (2), and possibly if he had agreed to formulation (1). In contrast, the SEC’s position is that the simple agreement to hold information confidential encompasses both formulations (2) and (3) and possibly formulation (1) as well. For example, under Regulation FD, the SEC permits the selective disclosure of material information to shareholders so long as they expressly agree to hold the information confidential; the SEC clearly would not permit shareholders to trade on such information under these circumstances.<sup>7</sup>

The SEC’s view notwithstanding, the court’s opinion in the *Cuban* case, as it currently stands, supports the argument that an agreement merely to hold information confidential does not necessarily obligate the recipient to refrain from trading on the information. Accordingly, providers of confidential information may wish to make explicit in written confidentiality agreements that the recipient agrees to (i) hold the information confidential and (ii) refrain from trading on the information.

## Implications for Recipients of Confidential Information

It is unwise to conclude based on *SEC v. Cuban* that a person who merely agrees to hold information confidential may safely trade in the company’s securities while in possession of such confidential information. The *Cuban* case was decided at the district court level and remains subject to an amended complaint and possible appeal. Moreover, as noted above, the SEC has strongly disagreed with the analysis employed by the district court. To avoid insider trading liability, a recipient should consider attempting to remain “public” by requesting at the outset of any communication with a corporate insider that the insider not reveal any information that is material and nonpublic or that would otherwise preclude the recipient from trading in the securities. However, even such a request may not protect the recipient from insider trading liability if the recipient owes a fiduciary duty to the company.

## An Aside on Assent

The court’s review of the law of insider trading in the *Cuban* opinion discusses a series of cases holding that “outside a fiduciary or fiduciary-like relationship, a mere unilateral expectation on the part of the information source cannot create the predicate duty” for establishing insider trading liability.<sup>8</sup> The assent of the recipient is required. Assent may be oral, as Mr. Cuban’s apparently was, or it may be implied by facts and circumstances. The facts and circumstances of assent may be murky and subject

<sup>6</sup> *Cuban* at 13.

<sup>7</sup> May 30, 2001 Interim Supplement, available at <http://www.sec.gov/interp/telephone/phonesupplement4.htm>.

<sup>8</sup> *Cuban* at 10.

to later dispute. For example, silence may indicate assent in some cases, such as where a recipient continues to engage in a conversation after being informed of the provider's expectation of confidentiality, but silence, or the mere acceptance of confidential information, may not indicate assent in other cases.<sup>9</sup> Accordingly,

when confidentiality is critical, it may be advisable not to deliver confidential information before the parties execute a written confidentiality agreement.

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<sup>9</sup> *Walton v. Morgan Stanley & Co.*, 623 F.2d 796, 799 (2d Cir. 1980).

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